



**Testimony of
Harvey B. Grossblatt, Chief Executive Officer
Universal Security Instruments, Inc.
before the
United States House of Representatives
Committee on Small Business on
Sarbanes-Oxley Section 404:
New Evidence on the Costs for Small Businesses
December 12, 2007**

Madam Chairman and members of the Committee, on behalf of Universal Security Instruments, Inc., I would like to thank you for the opportunity to comment on the issue related to Sarbanes-Oxley Act Section 404 with regards to Non-Accelerated Filers.

My Company was founded in 1969 and has been a public company since 1973. I believe we were the second company to list on NASDAQ. In July 2003, we moved our listing to the American Stock Exchange, which we believed was a better exchange for our shareholders.

When Sarbanes-Oxley was initially implemented, I believe it was needed to restore investor confidence in the wake of accounting scandals. The problem with the legislation was it did not make any distinctions between very large corporations which were seen as the cause of the loss of confidence by investors, and small cap companies. I anticipated it would not be required due to costs associated with implementing that specific Section for small cap companies. Much to my surprise, despite the Advisory Committee recommendations, Section 404 was implemented for small cap companies over a two year period.

I thought Congress had realized that small cap companies do not have the accounting staff to support Section 404 and consequently provided a delay for small cap companies.

At first, our annual audit and legal fees increased approximately 50% as a result of Sarbanes-Oxley legislation, which cost our shareholders approximately \$100,000 per year. Once we were advised that, much to our surprise, we were required to implement Section 404 this year, my company interviewed approximately six consulting firms and received estimates between \$150,000 and \$300,000 for initial compliance and \$50,000 to \$100,000 for annual testing. Additionally, our audit fees will increase approximately \$50,000 annually, due to the additional testing required. With the implementation of Section 404, my company will spend approximately \$150,000 to \$200,000. Once Section 404 is adopted, we are estimating at least \$100,000 annually in addition to our substantially higher legal and audit fees. From my perspective, I would like to discuss the problems that small cap companies experience with Sarbanes-Oxley, and particularly Section 404.

1. We will have spent 3%-4% of our shareholder equity on compliance since Sarbanes-Oxley was approved.
2. We are estimating this year's earnings will be reduced by at least 5% because of Section 404 implementation costs, without getting any return on the investment. That translates into a lower stock price, which I believe hurts our shareholders.
3. Since my company made the *Fortune Small Business Magazine* list in 2006 and 2007 of the Top 100 Fastest-Growing Small Public Companies in the U.S., our shareholder base has changed to 1/3 institutional. The institutional shareholder does not care about the cost of implementing Sarbanes-Oxley and it makes year-over-year comparisons more difficult because institutional shareholders may not factor in the disproportionate impact of SOX expenses on earnings of smaller companies.
4. Small public companies are generally entrepreneurial, with the executives being hands-on and who generally own significant amounts of stock. Significant stock ownership by management is a very powerful incentive to insure proper financial oversight. As it is, under the Section 404 rules, my time is being diverted from trying to grow the business to documenting that I have reviewed transactions, trying to make sure that we will not have a material weakness and significant deficiency. In my opinion, this does not help our shareholders.
5. My company has been contacted by numerous venture capitalist firms to explore the possibility of going private to avoid the costs associated with Sarbanes-Oxley. Additionally, we have been sent information about listing on the London AIM Exchange. If we would go private, it may be beneficial to management, but not our shareholders. We still believe our shareholders have the right to participate in our future growth.

6. It has been difficult for our company to find directors, especially with the additional responsibility of various committees as well as finding a director who can Chair the Audit Committee.

Since most small cap companies are run by entrepreneurial management, with a significant financial stake in the company, does it make sense that small cap companies be required to have the same controls of a Fortune 500 company? In my company, management is hands-on and signs every purchase order and check.

In closing, I believe approximately 94% of the equity markets in the United States are fully subject to Section 404, leaving 6% not covered by Section 404¹. It seems to me the primary beneficiaries of Section 404 for small companies are the consultants, auditors and lawyers – and not the shareholders the Sarbanes-Oxley law was trying to protect.

Thank you for the opportunity to share my experience with you and to provide input on this important issue. I will be happy to answer any questions you may have.

¹ Final Report of the Advisory Committee on Smaller Public Companies to the Securities and Exchange Commission, April 23, 2006, page 7. <http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf>